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## Reserve Funds to Launch Sweeps for Small Banks

American Banker • Thursday, July 20, 2000

By MATTHEW HUNTER

Reserve Funds of New York is set to launch a product designed to make it easier for banks, particularly small ones, to pay interest on commercial checking accounts.

Big banks have gotten around federal restrictions on offering interest on business checking through the use of sweep accounts, in which repurchase agreements let them keep client deposits on the books while "sweeping" them to a money market mutual fund and back.

The Reserve Return Sweep account, which will be available Aug. 1, will use a technological solution to eliminate the administrative hassles of the repurchase agreement, said Bruce Bent 2d, co-creator of the product and president of the company. It will also allow an unlimited number of sweep transactions from the fund to the deposit account, sidestepping a federal limit of six such transactions a month, he said.

Frontier Bank of Everett, Wash., will be the first bank to use the account for its commercial depositors. The

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bank had been looking for a product that could pay interest on commercial deposits without hampering loan growth, said John Dickson, senior vice president of its parent, Frontier Financial Corp.

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The Reserve Return Sweep account is designed for banks with assets of up to \$3 billion, whose ability to fund loan growth would be hampered by repurchase agreements, Mr. Dickson said. Such agreements wipe collateral from institutions' books that they could otherwise use to secure borrowings from the Federal Reserve or the Federal Home Loan Banks, he said.

For banks like \$1.6 billion-asset Frontier, the alternative to Reserve Funds' new account is to incur the expense of offering high-interest-bearing certificates of deposit, which are currently yielding around 7% in the Pacific Northwest, Mr. Dickson said. By using Return Reserve Sweep, the bank would be able to keep the deposits on the books to fund lending, he said.

"This allows me to compete with nonbanking institutions" for customer deposits, Mr. Dickson said. Before deciding to go with the Reserve Funds product, Frontier was close to signing a deal with Fidelity Investments for sweep services, he said.

Mr. Bent would not explain how his firm will skirt the six-transfer monthly limit for sweep accounts, beyond saying it involves the use of technology. The firm is applying for a patent, which could take up to a year and a half to obtain, he said.

Mr. Bent also said Reserve Funds developed the first money market account (a claim others dispute), in the 1970s, and regretted not patenting it.

Anthony J. Carfang, a partner at Treasury Strategies in Chicago, said he doubts that Reserve Funds will be able to get a patent, which is rarely granted for intellectual property.

Getting around the regulation on transfers also raised questions. A firm could have the bank hold shares of a money market fund and transfer deposits back and forth, for example, but doing that would likely be very complex, Mr. Carfang said.

Congress for several years has debated revising or eliminating Regulation Q, which restricts interest-bearing commercial checking, but Mr. Dickson said banks are uncertain when or even if Congress would follow through on any proposals.

The House recently passed a bill that would increase the number of transactions allowed to 24 a month and eliminate the ban on commercial checking interest three years after enactment, but it is unclear how far the bill will go in this session.

If Congress fails to pass a bill reforming Regulation Q, Reserve Funds' new product "could catch on like wildfire," Mr. Dickson said.

Money market funds are widely perceived as among the first products to successfully draw deposits away from banks on a large scale. Mr. Bent

~~hopes that Reserve Return Sweep will give banks a competitive edge in the market for customers' deposits.~~

Frontier plans to begin aggressive marketing of the product in early fall, and hopes to save money and give its business customers more incentive to keep more of their assets at the bank, Mr. Dickson said. The bank is looking at a variety of fee schedules.

Mr. Bent said 95% of Reserve Funds' money market assets come from brokers and that the company hopes Reserve Return Sweep will help expand its business into banks.

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